SCS Agency
Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author: Campbell Analyst: Marion Mann DeJong Bill Number: AB 2441

Related Bills: See Legislative History Telephone: (916) 845-6979 Introduced Date: 02/20/98

Attorney: Doug Bramhall Sponsor:

SUBJECT: Manufacturers' Investment Credit/Qualified Property Includes Computers & Peripheral

SUMMARY

This bill would include specified activities relating to computer programming and computer software described in Standard Industrial Classification (SIC) Codes 7371 to 7373 in the definitions of "qualified taxpayer" and "qualified property" under the Manufacturers' Investment Credit (MIC).

EFFECTIVE DATE

As a tax levy, this bill would become effective immediately upon enactment and would apply to taxable or income years beginning on or after January 1, 1998.

LEGISLATIVE HISTORY

SB 671 (Stats. 1993, Ch. 881); SB 676 (Stats. 1994, Ch. 748); AB 2661 (1995/96); SB 38 (Stats. 1996, Ch 954.); SB 1106 (Stats. 1997, Ch. 604); AB 94 (1997/98); AB 1063 (1997/98); AB 1976 (1997/98).

SPECIFIC FINDINGS

Existing state and federal laws generally allow a depreciation deduction for the obsolescence or wear and tear of property used in a business or investment property. The property must have a limited, useful life of more than one year and includes equipment, machinery, vehicles and buildings, but excludes land. Property is assigned to specific classifications related to the number of years of its useful life. The property then may be depreciated over the number of years of its useful life (recovery period).

Existing state and federal laws allow a taxpayer to deduct expenses paid or incurred in the ordinary course of a taxpayer's business.

Existing state law allows taxpayers to use various credits against tax. The MIC allows qualified taxpayers a credit equal to 6% of the amount paid or incurred after January 1, 1994, for qualified property that is placed in service in

DEPARTMENTS THAT MAY BE AFFECTED:

____ STATE MANDATE ____ GOVERNOR'S APPOINTMENT

Board Position:	Agency Secretary Position:	GOVERNOR'S OFFICE USE
____ S ____ O ____ SA ____ OUA ____ N ____ NP ____ NA ____ NAR ___X_____ PENDING	____ S ____ O ____ SA ____ OUA ____ N ____ NP ____ NA ____ NAR DEFER TO ____________	Position Approved ____ Position Disapproved ____ Position Noted ____
Department Director Date G. Alan Hunter 3/30/98	Agency Secretary Date	By: Date

California.

For purposes of the MIC, a qualified taxpayer is any taxpayer engaged in manufacturing activities described in specified codes in the SIC Manual. Qualified property is any of the following:

1) Tangible personal property that is defined in Section 1245(a) of the Internal Revenue Code and used primarily:

- for manufacturing, processing, refining, fabricating or recycling of property;
- for research and development;
- for the maintenance, repair, measurement, or testing of otherwise qualified property; or
- for pollution control which meets or exceeds state or local standards.

2) The value of any capitalized labor costs directly allocable to the construction or modification of the property listed in #1 above or for special purpose buildings and foundations listed in #3 below.

3) Special purpose buildings and foundations that are an integral part of manufacturing, refining, processing or fabricating, or research and storage facilities that are part of the process, which are used by qualified persons performing manufacturing activities described in specific codes relating to computer, accounting, and office machines, electronic equipment and accessories, biotech or biopharmaceutical activities, semiconductor equipment manufacturing activities and certain aerospace manufacturing activities.

The MIC explicitly excludes certain types of property from the definition of qualified property, including equipment used in the extraction process, furniture, facilities used for warehousing purposes after completion of the manufacturing process, inventory, equipment used to store finished products that have completed the manufacturing process, and tangible personal property used in administration, general management, or marketing.

The MIC provides a variety of special rules for costs paid pursuant to a binding contract and leased property. The credit may be carried over until exhausted, for a maximum of eight years. For small businesses, this carryover period is extended to ten years. The taxpayer must recapture any credit previously allowed if the property is removed from California, disposed of to an unrelated party or converted to an unauthorized use within one year from the date the property is first placed in service in California.

The MIC will become inoperative on January 1, 2001, or on the January 1 of the earliest year after 2001 if the total employment in manufacturing in this state does not exceed by 100,000 jobs the total employment in manufacturing in this state on January 1, 1994. The Employment Development Department (EDD) is required to report to the Legislature annually on this determination.

Certain “new businesses” (as defined) may claim an exemption from sales and use tax instead of this tax credit. The existing sales and use tax law also allows a taxpayer to claim a refund for the sales or use tax that was paid on the purchase of qualified property rather than claiming the MIC.

This bill would include specified lines of business relating to computer programming and computer software in the definition of "qualified taxpayer" under the MIC. These activities are described in SIC Codes 7371 (Computer Programming Services), 7372 (Prepackaged Software) and 7373 (Computer Integrated Systems Design).

This bill also would include, under the MIC definition of "qualified property" computers and computer peripheral equipment that is tangible personal property, as defined in Section 1245(a) of the Internal Revenue Code, used in these same lines of business relating to computers primarily for the development and manufacture of software.

This bill would replace the January 1, 1994, date in the binding contract language with January 1, 1998, so that the qualified costs and the binding contract rules applicable to taxpayers involved in computer and software activities have the same operative date.

Policy Considerations

The SIC code references added by this bill describe some service activities. No other MIC provisions relate to providing services.

Implementation Considerations

The term "computers and computer peripheral equipment" is not defined. Undefined terms can lead to disputes between the department and taxpayers. Internal Revenue Code Section 168(i)(2)(B) provides a definition for computer or peripheral equipment for purposes of the accelerated cost recovery system (ACRS).

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact the department's costs.

Tax Revenue Estimate

This proposal is estimated to impact PIT and B&CT revenues as shown in the following table.

Fiscal Year Cash Flow Taxable Years Beginning on and After January 1, 1998 Enactment Assumed After June 30, 1998 $ Millions			
Fiscal Year	1998-99	1999-00	2000-01
Applied credits	($12)	($13)	($16)
Unused carryover credits	$21	$33	$44

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Tax Revenue Discussion

The revenue impact for this bill would be determined by the level of qualified costs and the amount of credits applied against available tax liabilities.

This estimate was developed in the following steps. The amount of qualified costs was estimated from national data (U.S. Department of Commerce) for SIC code 737. That amount was adjusted, using sales receipt data, to provide a proxy for the portion of overall investment reasonably assumed to be accounted for by activities in SIC codes 7371, 7372, and 7373. The next step was to estimate the portion of national investment that would occur in California. California's share of the total was obtained by adjusting the U.S. capital expenditure figure by the ratio of California's employment over U.S. employment in SIC codes 7371, 7372, and 7373. The qualified expenditures for 1993 ($283 million) were grown to approximate levels for 1998 and beyond. The final step was to estimate the amount of credit that would be used. This was accomplished using a microsimulation model of tax returns from prior years.

BOARD POSITION

Pending.